

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT

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It was announced in late November 2001 the current recession had begun over a half year earlier in April 2001. While most would agree the economy was in a downturn last year, many were surprised it had started so early. Perhaps the reason it took so long to recognize the economy was in a recession is it's been so long since we've had one. After all, the last recession occurred over a decade ago. Given the extended span between the previous and current recession, this may be a good time to present a short primer on business cycles, expansions, and recessions.

In the long run the economy expands. However, actual real GDP performance varies around this trend growth. This variation is the business cycle, which can be divided into two parts: expansion and recession. Two other important concepts are peaks and troughs. During an expansion, output grows from a low point, or trough, until it achieves a high point, or peak. A recession measures the contraction from the peak to the trough. Traditionally, recessions are measured by their duration and decline in output. For example, the 1990-91 recession lasted eight months and real GDP declined 1.4% over this period.

This was mild compared to historical recessions. There have been 31 business cycles since 1854. During this period the average recession lasted 18 months and the average expansion was about twice as long. Interestingly, it appears recessions are becoming shorter and expansions are lasting longer. This can be seen in the post-World War II business cycles. Since 1945 there have been 9 business cycles. During this period recessions lasted an average of 11 months, but expansions lasted nearly five times as long (50 months). Things were even more lopsided in the previous recession. The eight-month long 1990-91 recession followed the record 120 month expansion. This evidence dovetails with recent research that suggests recessions are indeed getting shorter, shallower, and less frequent.

Of course, every recession is unique, and the current recession is no exception. Most recessions are caused by a decline in consumer spending. But, the current recession is being led by a collapse in investment. Consumer spending was impacted by the terrorists' attacks, but it seems to be rebounding. Another unique

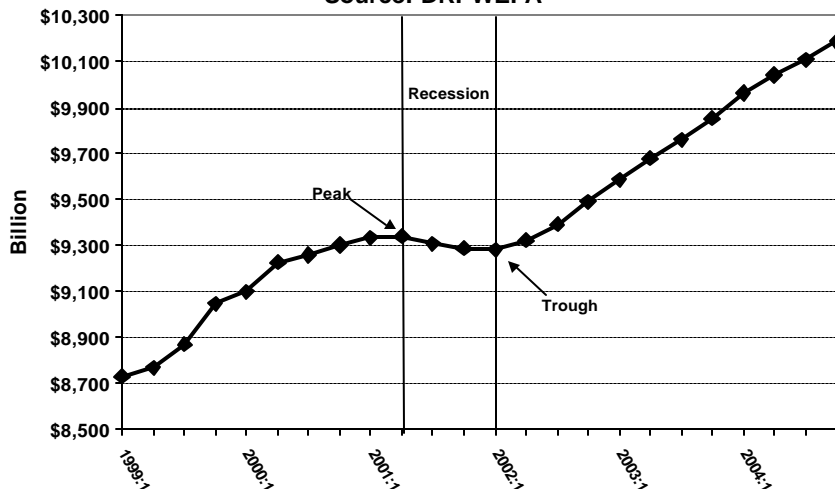
aspect of this recession is the large amount of stimulus that has been injected into the economy. For example, the Federal Reserve began lowering interest rates in January 2001—three months before the recession started. Fiscal policy has also been proactive. Last summer's federal individual income tax rebates helped consumer spending. Even the private sector stepped up to the plate. Interest-free loans by automobile manufacturers accelerated the purchase of cars. Inventories have been whittled down to the point where new production needs to take place. All these factors suggest this recession will be mild.

Unfortunately, not all sectors will recover at the same pace. As mentioned, this recession is largely the result of weak investment spending, and investment will take longer to recover than the overall economy. This is because previous capital spending and the slowdown in the global economy have left the world awash in excess capacity. Until this surplus capacity is worked off, investment spending will be suppressed. As a result, real investment probably will not grow again until the second half of this year – about six months after the anticipated end of the recession. It should be noted that employment is a lagging indicator of the economy's health. That is, the employment picture is not expected to improve until after the recession ends. This is because businesses will be hesitant to expand their payrolls until they are convinced the recession is over and the recovery is established. Until then, businesses will use other options, such as increased overtime, to meet increased demand. Once these options are exhausted, companies will once again begin adding new employees.

One thing all recessions have in common is they end sooner or later. Given the current conditions, it appears this one will end sooner than later.

U.S. Real Gross Domestic Product

Source: DRI*WEFA



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General Fund Update

As of December 31, 2001

| <u>Revenue Source</u> | <u>\$ Millions</u> | | |
|---------------------------------------|--|--------------------------------------|---------------------------------------|
| | <u>FY02 Executive Estimate³</u> | <u>DFM Predicted to Date</u> | <u>Actual Accrued to Date</u> |
| Individual Income Tax | 940.2 | 413.5 | 408.4 |
| Corporate Income Tax | 93.4 | 36.4 | 23.9 |
| Sales Tax | 659.4 | 338.6 | 338.6 |
| Product Taxes ¹ | 20.6 | 10.8 | 10.8 |
| Miscellaneous | 110.6 | 44.3 | 41.6 |
| TOTAL GENERAL FUND² | 1,824.2 | 843.6 | 823.3 |

¹ Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
² May not total due to rounding
³ Revised Estimate as of January 2002

December General Fund revenue fell \$20.3 million short of the month's predicted level. This result is based on the most recent FY 2002 revenue forecast (released in mid-December) measured against historical collection patterns. Careful analysis of the details behind this December result suggests the situation is not as bad as it appears.

Individual Income Tax collections were \$5.1 million lower than the target for December. Filing payments were \$4.7 million lower than expected, but this is not particularly informative, since December and January filing payments are two parts of the same phenomenon – year-end state income tax payments made for the purpose of deducting those payments on the taxpayer's federal tax return. Well over half of the year end payments show up in January's collections, so we're a month away from useful information. Refunds in December were actually \$0.4 million lower than expected. Withholding collections were \$0.9 million lower than expected in December, which is within 1.5% of

the amount expected. This is a statistically insignificant variance.

Corporate Income Tax was the locus of December's revenue shortfall, accounting for \$12.5 million (almost two-thirds) of the total variance. Within the Corporate Income Tax the problem was concentrated in the estimated payments category. Over the past fourteen years December has accounted for anywhere from 15% to 40% of total estimated payments received in an entire fiscal year. The expected amount for this December was 20% of the year's forecast. Actual estimated payments in December were 9% of the amount currently forecast. Either something is happening in this collection category that has never happened before, or this element of the current forecast is too high. The Tax Commission has recently received "a flurry" of requests for time extensions due to the fallout associated with the businesses destroyed in the World Trade Center collapse. This points to the possibility of a "never happened before" type of explanation for December's weak

corporate estimated payments, but it is too early to tell if this is really a significant factor. Meanwhile, on a positive note, Corporate Income Tax refunds were \$1.4 million lower than expected in December and filing payments were \$0.2 million higher than expected.

Sales Tax revenue was exactly on target in December. This reflects November sales activity, so it will be another month before we know how the always-important holiday sales season performed this year.

Product taxes were also exactly on target in December. Miscellaneous Revenue was \$2.7 million lower than expected. Four items (interest earnings, insurance premium tax, alcoholic beverage licenses, and unclaimed property) account for all this weakness. In each case it appears the December shortfall is strictly a matter of timing. All four items are expected to reverse December's weakness by the end of this fiscal year.